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UNCLAS SECTION 01 OF 02 TAIPEI 001171

SIPDIS

SENSITIVE

DEPT FOR EAP/TC, EAP/EP AND EB/IFD/OIA
DEPT PLEASE PASS AIT/W AND USTR
USTR FOR SCOTT KI
USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/MOGHTADER
TREASURY PLEASE PASS TO OCC/AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

E.O. 12958: N/A

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SUBJECT: MARKETS STEADY AS TAIWAN REACTS TO ANTI-SECESSION
LAW

REF: TAIPEI 1029

Summary

1. (SBU) Taiwan's stock market showed a significant drop March 14 and 15 as the PRC passed the Anti-Secession Law and Taiwan's officials reacted. The NT dollar also lost value. However, it is unclear whether these declines were a result of the Anti-Secession Law or completely unrelated factors. Regardless, the stock market's slight recovery on March 16 showed that nerves were calming. Investors may be withholding judgment to see how Taiwan reacts in the days leading up to the March 26 protest demonstration in Taipei. If the Chen administration can maintain a fairly moderate response, the markets may not be affected at all. End summary.

The Markets React...to What?

2. (U) On March 14, 2005, the PRC's National Peoples' Congress enacted the Anti-secession Law after releasing its complete text for the first time. Although President Chen Shui-bian initially remained uncharacteristically quiet, his administration's officials responded with strong condemnation. Taiwan authorities have called for a one million-person demonstration in Taipei on March 26 to protest the laws.

3. (U) Taiwan's stock price index lost 140.75 points during March 14 and 15 to 6,063.48 points. The single-day loss on March 15 was 1.5 percent. Over 80 percent of listed issues posted stock price losses on March 15. Foreign portfolio investors sold more than they purchased. Their net stock sales totaled NT\$2.4 billion on March 14 and NT\$3.3 billion on March 15. The NTD depreciated 1.2 NT cents on March 14 and 16.8 NT cents on March 15 to NTD 31 per USD. However, markets may also have been responding to expectations of an interest rate hike by the U.S. Federal Reserve Board on March 22 that generally weakened Asian currencies.

...and Return to Calm

4. (U) After Monday's and Tuesday's declines, Taiwan's stock market index inched up 0.15% March 16 to close at 6,072.36 points. Of 1,007 issues listed on the stock market, 48.7% reported drops in stock prices on March 16, much less than the 82.5% of listed stocks a day earlier. Foreign investors again posted net stock sales of NTD 5.5 billion on March 16. The March 16 trading volume of NT\$59.5 billion was less than the normal daily volume of NT\$80-100 billion. Huang Wen-jur, a senior consultant to the SinoPac Securities Company, told AIT/T that the smaller trading volume reflected portfolio investors' wait-and-see attitude.

5. (U) On the foreign exchange market, the NT dollar lost 2.7 NT cents to NT\$31.027 per US dollar. The depreciation of 2.7 NT cents on March 16 was much smaller than the decline on March 15. The trading volume of US\$1.2 billion was also lower than US\$1.5 billion on the previous day. Alex Pan, a senior foreign exchange trader with the Bank of America, commented that Taiwan's market had been relatively calm because the NT dollar's depreciation of 0.6% against the US dollar on March 15 and 16 was much less than the 2% devaluation for Korean won.

No Capital Flight

16. (SBU) There has been no evidence of capital flight in reaction to the Anti-Secession Law. George Chou, Director General of the CBD's Foreign Exchange Department (strictly protect), told AIT/T that on March 15 foreign portfolio investors continued to post net inward remittances of dozens of millions of USD. On May 16 and 17, there was some small capital outflow because hedge funds pulled money out of Asia, including Taiwan, South Korea, Singapore, Malaysia, and Indonesia. George Chou quoted a source at State Street, one of the three largest custodian banks in the United States, to explain that hedge fund withdrawals from Asia in general was one main cause for recent weakness of Asian currencies.

Comment) Market Holding Its Breath

17. (SBU) It is not clear whether the modest declines in the stock market and the value of the NT dollar early this week were a reaction to the release of the full text of the PRC's Anti-Secession Law, its passage by the National People's Congress, Taiwan officials' response or any number of other factors completely unrelated to the new law. Regardless, the reaction was small. Wednesday's slight stock price recovery shows that the markets' nerves are relatively steady as it waits to see the results of moves and countermoves by Taiwan and the PRC in the days leading to the March 26 protest demonstrations in Taipei. If the PRC's actions, the international reaction, and the domestic political environment offer the Chen administration the maneuverability to maintain some measure of moderation in its response, then the Anti-Secession Law could turn out to be a non-event for Taiwan's financial markets. End comment.
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